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LEBANON
FINANCIAL/SECURITIES
MARKET DEVELOPMENT

National Council Development Plan
(REVISED)

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NATIONAL COUNCIL DEVELOPMENT PLAN

CHAPTER 1 - INTRODUCTION

The purpose of the National Council Development Plan is to lay the groundwork for the project to assist the Government of Lebanon in the establishment and development of the National Council of the Financial Markets ("National Council"). The detailed plans produced will assist in defining the necessary commitments on the part of the Government of Lebanon and act as a monitoring tool for the life of the project. It is intended that the detailed plans will be refined and modified during the life of the project with the agreement of all parties.

A critical element for the planning of Stages 1 and 2 is the passage of the Law of Financial Markets ("the Law") through Parliament. The Law is currently in its final stages of drafting and has been submitted to the Beirut Stock Exchange, Lebanese Bankers Association and others for comment. Comments have also been submitted by the consultant and these will be incorporated in a later draft. The National Council Development Plan assumes completion of the drafting of the Law by end November 1997 and its passage through Parliament during February 1998. In the event that this is not achieved, further work beyond the drafting of the high and medium priority bylaws may be re-scheduled or the project suspended until such time as the Law progresses through Parliament. It is essential therefore that the Banque Du Liban, which is responsible for drafting the Law, identifies and documents the further steps to be taken in progressing the Law through Parliament and establishes a timetable of activities aimed at passage of the Law through Parliament by mid-February 1998.

The National Council Development Plan comprises six basic components:

- Organisation and Staffing: a definition of the organisational structure of the National Council including the identification of staff duties and responsibilities in the form an organisational chart.
- Action Plan & Budgets: a definition of the tasks and activities to achieve the proposed organisational design including initial estimates of projected budgets for the first three years together with recommendations for appropriate revenue sources.
- Regulatory Development: the identification and prioritisation of the drafting and issuance of the bylaws, rules and regulations to be issued in support of the Law of the Financial Markets.
- Procedural Development: a schedule of the activities to be undertaken to accommodate the National Council and its staff.
- Administrative Development: the identification of reporting relationships and management functions within the National Council including an outline assessment of its systems needs.
- Skills Development: an assessment of the training needs and how these will be met.

Where possible, we have referred in this report to comparisons that we have drawn from other regulatory bodies. However, the overall structure of the National Council, especially in relation to its organisation and staffing, is that which is appropriate to Lebanon and reflects both the current and projected activities of the Lebanese financial markets and the role played by the directors and staff in regulating those markets.

CHAPTER 2 - ORGANISATION AND STAFFING

Functions and Responsibilities of the National Council

The National Council is charged with the function under Article 4 of the Law to "protect the savings invested in securities and financial instruments to be offered for public subscription, namely savings invested in financial markets for the purpose of promoting and spurring investment in these markets."

To discharge the declared function, the National Council has the following responsibilities (These are in keeping with provisions generally found in the securities laws of most countries):

- to regulate the Beirut Stock Exchange and any stock market established in Lebanon;
- to regulate the depository and clearing company;
- to regulate persons and legal entities involved in securities business and the business of investment management on the Lebanese financial markets;
- to regulate entities for collective investment in securities and other financial instruments;
- to regulate companies and entities whose securities and financial instruments are listed in the financial markets, with particular regard to public disclosure;
- to regulate securities and financial instruments traded or offered for subscription in the Lebanese financial markets; and
- to determine the criteria for the establishment of a Financial Markets Investor Guarantee Fund.

Powers of the National Council

The Law confers the following powers to the National Council for it to discharge its responsibilities in a proper fashion:

- to make by-laws, regulations, instructions and recommendations for the implementation of the Law;
- to grant or reject licences to stock market companies, market intermediaries, and collective investment companies;
- to review the management and operation of Midclear in respect of its compliance with the Law;
- to approve the statute and amendments thereto of licensed companies;
- to suspend the activities in any of the stock markets, whenever its continuation is considered harmful to the public;
- to approve the regulations set by a stock market administration regarding

obligations of listed companies;

- to certify decisions of stock markets regarding the registration of securities, and to cancel or reject the registration under certain circumstances;
- to grant licenses to companies to publish or disclose to the public the information required by the Law and by regulations;
- to appoint auditors to perform an audit on licensed companies and entities for the benefit of the National Council;
- to conduct investigations into alleged breaches of the Law, regulations and market malpractice and to impose sanctions, where appropriate;
- to receive, investigate and seek resolution of complaints;
- to supervise the operations of the Financial Markets Investor Guarantee Fund;
- to conduct disciplinary hearings (by the Disciplinary Committee) and to impose administrative sanctions; and
- to transfer to the Court of Financial Markets suspected cases of market manipulation as defined under article 20.

The above provisions, with the exception of the establishment of the Court of Financial Markets, are generally found in the securities laws of most countries. Normally it is the regulatory body itself, i.e. the National Council, which decides on cases of market manipulation where the accused is a regulated person or regulated entity. Market manipulation by non-regulated persons is rare and generally the onus is placed on the regulated entity to ensure that its dealings on behalf of its clients do not result in the manipulation of the market. Only in cases of insider trading, where this tends to be a criminal offence, often committed by non-regulated persons and punishable by terms of imprisonment, do the courts, rather than the regulatory body, deal with the offence. The Court of the Financial Markets should assist in two ways. First, it will ensure that offences are dealt with by persons who are experienced in and understand the financial markets (often courts and in particular juries do not understand market terminology resulting in the failure by the prosecution to prove its case). Second, it will avoid possible lengthy delays in taking the matter through the normal legal system.

Organisation

It is proposed that the National Council be comprised of several functional departments for the effective discharge of its duties. The division of responsibilities of departments and their sizes needs to be commensurate with the scope and nature of the activities being regulated.

Given the size of the current market, the number of market participants and listed companies, it is proposed that the Office of the National Council should start off on a scale that is appropriate to the current environment; to be

strengthened and re-organised as a result of expanded activities and responsibilities.

The following functional departments are proposed:

- The Department of Market Supervision;
- The Department of Securities Institutions;
- The Department of Corporate and Legal Affairs; and
- The Administration Department.

The Department of Market Supervision is responsible for supervision of stock markets and the depository and clearing company. This includes:

- review and recommend to the board of directors the grant of licence for establishment of stock markets and the depository and clearing company;
- review and recommend to the board of directors, renewal, suspension or revocation of licences of stock markets and the depository and clearing company;
- review and recommend to the board of directors approval of rule changes of stock markets and the depository and clearing company;
- review and recommend to the board of directors approval of new market instruments including investment funds;
- review of the constitution, structure and management structure including the rules, finance and staffing etc. of the exchange and clearing company;
- review of supervision by stock markets of trading by market members;
- review of operational areas in trading, clearing and settlement;
- review of supervision by exchanges of listed companies;
- inspection visits to stock markets and the depository and clearing company;
- supervision of establishment and operation of the Financial Markets Investor Guarantee Fund;
- day-to-day market surveillance, including operation of the market surveillance system; and
- information gathering on market activities.

The Department of Securities Institutions is responsible for regulation and supervision of securities companies, underwriting, investment advisors and their representatives. This includes:

- recommending to the board of directors approval, renewal, rejection, suspension and revocation of licences;

- supervision of trading activities of licensed persons;
- setting codes of conduct and compliance manual for licensed persons, regulation of industry associations e.g. securities dealers association;
- recommending to the board of directors policies and standards on advertising;
- financial supervision of licensed persons, including examining financial returns and conducting regular and surprise inspection visits; and
- liaison with compliance officers of licensed companies.

It will also include licensing and supervision of investment fund managers and fund administrators.

The Department of Corporate and Legal Affairs comprises two units - the *Public Offering and Continuous Compliance Unit* and the *Enforcement Unit*.

The *Public Offering and Continuous Compliance Unit* is responsible for all corporate finance matters, and enforcement of company disclosure requirements. This includes:

- certifying decisions of stock markets regarding registration of securities and financial instruments;
- approval of prospectuses of new issues and circulars to shareholders;
- approval of further issues e.g. rights issues;
- monitoring of compliance with continuing obligation of listed companies;
- monitoring of disclosure of directors' and substantial holdings;
- supervision of take-overs and acquisitions;
- recommending to the board of directors approval of collective investment schemes; and
- approval for and supervision of investment funds.

The *Enforcement Unit* is responsible for enforcement of the investigation provisions of the law and regulations. This includes:

- handling of complaints, both verbal and in writing;
- conducting investigations into allegations of malpractice relating to securities trading and contravention of the Law and regulations. In some cases, preliminary enquiries are conducted by the relevant departments, but when the enquiry reveals that further investigation is warranted, the case is referred to the Enforcement Unit for full investigation; and
- prosecution of cases to be heard by the Disciplinary Committee and the Court of Financial Markets.

The head the Department of Corporate and Legal Affairs will also be responsible for all legal matters pertaining to the Council and will be supported in this by the Legal Expert. This includes:

- preparation and issue of rules regulating the financial markets;
- constant review of the Law and bylaws;
- giving advice and assistance to the Council and other departments on all legal issues; and
- preparation of MOUs with other foreign regulators.

The Administration Department is responsible for the overall administration of the Council, including personnel, finance, revenue, and servicing the board of directors' meetings. This includes:

- human resource activities;
- budgeting and management of accounts and revenue;
- office administration;
- acting as secretariat to meetings of the Council, preparing papers for the Council and relaying Council's decisions to the respective departments for implementation, and
- providing administrative support to the Disciplinary Committee and the Court of Financial Markets.

The Administration Department is also responsible for public relations, as well as skills development and training for the Council staff and the industry. The department will be supported in this by the Legal and Markets Experts who will assist in the production of publications and training material. The department's responsibilities in this area include:

- development and publication of regular newsletters by the Council;
- development and issue of a hand book for investors;
- issue of consultative documents to industry participants on regulatory policies and activities;
- preparation of Council annual reports;
- organising regulatory training for the board and senior management of the Council, the Banque du Liban, the Ministry of Finance and the Beirut Stock Exchange;
- organising securities industry training courses for Council staff and market participants;
- establishment and operation of securities industry examinations; and
- collecting statistical data and information.

The National Council and its Staff

Under article 7, the Chairman, Deputy Chairman should dedicate themselves fully to their duties at the National Council. Under article 10, the Chairman has the widest prerogatives to administer the affairs of the Council and its daily operations in accordance with the provisions of the Law and regulations. The expert in financial markets and the legal expert in financial affairs will be not be full time and it is therefore essential that the questions of confidentiality and conflict of interest are borne in mind in appointing these experts.

Article 7 specifies that the Chairman, the Deputy Chairman and the two experts should possess university degrees, experience and moral qualities necessary for carrying out their duties.

The Chairman and his Deputy are appointed by the Council of Ministers upon the proposal of the Minister of Finance. The two experts are appointed by the Council of Ministers upon the proposal of the Chairman of the Board of Directors.

The Chairman

As head of the securities regulatory body of Lebanon, the Chairman should be involved in all policy issues relating to the development of the financial markets of Lebanon, including the development of new instruments. He will also be responsible for public relations in Lebanon, press releases, press and TV interviews, public speeches etc. In addition, he will represent Lebanon in international conferences and international securities organisations e.g. the International Organisation of Securities Regulators; assisted by his Deputy and the two experts, where appropriate. The Chairman is also the Chairman of the Disciplinary Committee by virtue of article 22. Apart from overall responsibility for the supervision of the financial markets, the Chairman will have direct responsibility for the Corporate & Legal Affairs Department and the Administration Department.

The Deputy Chairman

As deputy head of the National Council, the Deputy Chairman will assist the Chairman in his duties and, where necessary, act in the place of the Chairman. In particular, he will be responsible for overseeing the efficient operation of the day-to-day functions of the National Council, with direct supervisory responsibilities over the following departments:

- Department of Market Supervision; and
- Department of Securities Institutions.

Financial Markets Expert

The Financial Markets Expert is a part time adviser to the Board of the National Council. He will advise and assist the Chairman in the development of the Lebanese financial markets advising on issues of supervision over the operation

of stock markets and the depository and clearing company, and in approving new instruments. He will also assist in the production of promotional and training material to be used by the National Council.

Legal Expert in Financial Affairs

The Legal Expert in Financial Affairs is a part time adviser to the Board of the National Council. He will provide the National Council with advice and support on legal affairs and assist the various departments in the proper discharge of their duties. In particular, he will provide support to the Corporate & Legal Affairs Department on policy matters relating to public issues and in the areas of continuing compliance, disclosure by directors etc. He will also assist in the production of promotional and training material to be used by the National Council.

Staffing in the Departments

The Department of Market Supervision, will be headed by a manager who will have experience in stock market operation and have an appropriate university degree. The manager, who will report to the Deputy Chairman, will be responsible for supervision of stock markets and the depository and clearing corporation. Day-to-day monitoring of market activities will be the responsibility of an assistant manager. A second assistant manager in the *Market Surveillance Unit* will be responsible for the operation of the National Council's surveillance system.

The Department of Securities Institutions will be headed by a manager who should preferably be a university graduate with experience in working in a securities institution or an accountant with experience in auditing financial institutions. He will report to the Deputy Chairman and be supported by an assistant manager who will be responsible for the *Licensing, Accounts and Audit Unit*. Clerical support will be provided by the Administration Department.

The Department of Corporate and Legal Affairs, will be headed by a manager who will have a law degree and experience as a corporate lawyer. He will be supported in his duties by an assistant manager who will carry out the functions of the Public Offerings and Continuous Compliance Unit, including vetting the offer documents, monitoring compliance of continuous obligations etc.

Until such time as the volume of work in the *Enforcement Unit* reaches a level that will require additional staff, the duties will be carried out by the Manager Corporate and Legal Affairs.

It is recommended that the National Council enlists the service of a core of three or four professional accounting firms for advice on the financial aspects of prospectuses, offer documents and circulars to shareholders presented to the Council for approval.

The Administration Department will be headed by a manager with experience in office administration, human resources and financial control. The manager, who will also be responsible for organising public relations and training events and for the publication of promotional material, will manage clerical and secretarial support services to other departments including the Council, and the Disciplinary Committee.

Organisation Chart

A chart on the above proposed organisation is attached Annex A

Annex B indicates a suggested take-on of staff.

CHAPTER 3 - ACTION PLAN AND BUDGETS

Action Plans

In the planning for the establishment and development of the National Council, we have assumed a passage of the Law through Parliament during February 1998. A plan of action which identifies the work still to be done on the Law, the processes through which it still has to pass and a timetable for the completion of the Law and its passage through Parliament is being prepared by the Banque Du Liban. This plan of action will form an integral part of the planning process for the establishment and development of the National Council.

Following acceptance of this report, the Resident Adviser will be on hand to support a small team of two markets people from the Banque Du Liban, together with a local lawyer in carrying out the preparatory work for the drafting of the bylaws. The drafting of the bylaws is expected to be completed in time for the passage of the Law through Parliament.

One month prior to the enactment of the Law, additional resources will require to be brought in to assist in the establishment of the National Council.

Annex C is an overall plan for the project which will be used for project management purposes.

Budget

In this section, we include a first estimate of the projected income and expenditure of the National Council during the first three years of operation. These figures are produced for information only and are not intended to be an official budget for the National Council. The intention is to give guidance to the National Council and to provide information which will assist the development team in assessing and scheduling the likely take-on of staff. It will also enable the development team to plan the development of systems to support the regulation of the financial markets. In addition to identifying projected expenditure during the first three years, we have set out projected development or establishment costs to be incurred during year one. Projected income is based on anticipated charges levied by the National Council.

No securities regulatory body makes or seeks to make a profit but rather to cover its development and operational costs. In all cases, throughout the world, the operational costs of regulatory bodies are borne directly by the industry. However, in almost all developing markets there has been a degree of support from the central budget in the establishment of the regulatory body. The support varies from country to country depending upon available finance. In almost all central and eastern European countries, for example, the establishment costs were paid by the governments concerned with technical assistance, and in some cases financial assistance, from donor agencies.

Expenditure

Development/establishment costs

	Lebanese pounds '000
Property [note 1]	
Fitting-out	30,000
Purchase of furniture	63,750
Purchase of cars	75,000
Administration [note 2]	
Printing and stationery	15,000
General office needs	15,000
Systems	
Office systems - hardware & software	150,000
Laser printers (2)	3,150
Office photocopier	9,000
Heavy duty copier/printing	7,500
Surveillance system [note 3]	562,500
Communications [note 4]	
Switchboard, phone lines and equipment	10,500
Fax	3,750
Legal and registration costs [note 5]	9,000
Total development costs	954,150

Note 1 - Property

Fitting-out: The cost of fitting out the National Council will depend upon the premises made available for its use. However figures have been obtained so that reasonable estimates for the various elements can be made.

Purchase of furniture: The costs for furniture have been based on the assumption that there would be three levels of style and quality, one for directors, one for management and one for other staff. Also included are provisions for meeting rooms and visitors.

Purchase of cars: This sum includes the cost of a suitable car plus driver for the Chairman only.

Note 2 - Administration

Provision has been made within the administration costs for one-off development expenses such as the design of the logo.

Printing and stationery: Office systems encompass the requisite hardware and software, cabling, printers and photocopiers.

Note 3 - Communications

The communications provision includes both external and internal lines, fax machines and integral answering machine.

Note 4 - Legal and Registration

The legal costs associated with establishing the National Council and registering it are provided for within this section.

Operational costs

	1998 '000	1999 '000	2000 '000
Directors' and Staff salaries (gross) [note 1]	1,604,304	1,764,734	1,941,207
Property			
Rental	247,500	247,500	247,500
Electricity/water	13,500	14,850	16,335
Cleaning	6,000	6,600	7,260
Administration [note 2]			
Printing and stationery	22,500	24,750	27,225
General office needs	37,500	41,250	45,375
Miscellaneous legal work	37,500	41,250	45,375
Audit and Accountancy work	22,500	24,750	27,225
Insurance	22,500	24,750	27,225
Systems			
Maintenance of office systems	17,000	18,500	20,150
Maintenance Surveillance System	56,250	56,250	56,250
Communications [note 3]			
Calls and line rental, e-mail	45,000	49,500	54,450
Travel (foreign, local etc.) [note 4]	60,000	66,000	72,600
Entertainment	30,000	33,000	36,300
Educational, Publications & Training	60,000	66,000	72,600
Capital items [note 5]			
Additional furniture		6,375	7,000
Additional office systems		15,000	16,500
Total annual running costs	2,282,054	2,501,059	2,720,577

Note 1 - Salaries

Salaries have been based on a 12 months period and include allowances for transport and children's education. They do not take into consideration the phasing-in of staff during 1998 as it is assumed that this will be offset by a charge from the Banque Du Liban for the secondment of its staff during the period up to the establishment of the National Council.

Note 2 - Administration

General office needs: these include subscriptions to international organisations.

Insurance: in addition to general insurance, this also includes medical coverage for staff.

Note 3 - Communications

This provision is for PTT costs of normal communications only, and not for costs which might be associated with an on-line computer system.

Note 4 - Travel (foreign, local etc.)

This allows for a restricted number of business trips by directors and senior management.

Note 5 - Capital items

An allowance has been made for the purchase of additional furniture and office equipment during the years 1999 and 2000.

General notes

Where relevant, costs in the years 1999 and 2000 have been increased to allow for an inflation factor of 10% per annum.

Expenses in relation to the Court of Financial Markets and the Disciplinary Committee, together with income from fines, have been treated as exceptional items and have not been budgeted for.

Income

Article 13 of the draft Law defines areas from which the National Council will derive its income:

1. At start-up 15 billion Lebanese pounds;
2. Aid, donations, grants, credit, loans;
3. Percentage of profits of the stock exchange (Note a);
4. Fee of up to a maximum of 0.2 per mil from a public offering with an upper ceiling of 5 times the minimum annual wage (Note b);
5. An annual fee of up to a maximum of 0.02 per mil of the value of the net assets of collective investment schemes with an upper ceiling of 5 times the minimum annual wage;
6. A fee, to be determined by the Board of Directors, for every document presented for its approval prior to publication with an upper ceiling of the amount of the minimum annual wage (this covers circulars, prospectuses and other documents issued by companies);
7. Penalties imposed on transgressors of the Law of up to 75 times minimum annual wage or, if the transgression resulted in a gain or minimising a loss, three to five times the gain or loss.

Note (a) The wording suggests that the stock exchange will make a profit. However, stock exchanges, especially in their formative years, do not make profits. Furthermore, by virtue of Article 14, the Beirut Stock Exchange will be turned into a member/shareholder owned company. Generally speaking, member owned stock exchanges are "not-for-profit" organisations (i.e. income equals expenditure) because the member owners see no advantage in the stock exchange making profits at their expense. At the suggestion of the consultant, the wording is to be amended to "payment of a fee prescribed by the Board of Directors".

Note (b) A brief analysis of other regulatory bodies suggests that they charge between 0.2 per mil and 0.33 per mil. However, none of the regulatory bodies sampled has an upper limit on this type of charge. It was suggested that the upper ceiling be removed from clause 4.

In considering the potential income of the National Council, we have made additional suggestions for revenue generation in common with most of the world's securities markets:

- Initial licensing of a stock exchange;
- Annual renewal of a licence issued to a stock exchange;
- Initial licensing of brokerage and portfolio management firms;
- Annual renewal of a licence issued to a brokerage or portfolio management firm;
- Initial licensing of collective investment schemes;
- Annual renewal of a licence issued to a collective investment scheme;

- Initial registration of individuals working for, or being a member of, any company or entity which is subject to the supervision of the Council;
- Annual registration of such persons;
- Fee, per examination subject, payable by individuals sitting a securities industry qualification examination;
- Annual fee payable by organisations accredited for the purpose of training individuals wishing to sit such an examination;
- Fee for a search of any register of legal entities or individuals that is maintained by the Council.

Article 13 is to be amended by the addition of clause 8 "Licences and fees for services as prescribed from time to time by the Board of Directors".

Projected Annual Income of the National Council

	1998 '000	1999 '000	2000 '000
Stock exchange(s) [note 1]			
Initial licensing		150,000	
Annual renewal	75,000	75,000	150,000
Public offerings [note 2]	77,700	131,400	177,000
Document vetting [note 3]	18,000	18,000	22,500
Brokerage and portfolio mgmt [note 4]			
Initial licensing	187,500	375,000	562,500
Annual renewal	390,000	465,000	615,000
Collective inv'ment schemes [note 5]			
Initial licensing	7,500	37,500	75,000
Annual renewal		7,500	45,000
Individuals [note 6]			
Initial registration	19,500	5,700	9,825
Annual registration	7,800	10,230	14,760
Examinations			
Fees per individual [note 7]	19,500	5,700	9,825
Training institutes [note 8]	7,500	7,500	15,000
Search fee [note 9]	300	300	300
Total projected income	810,300	1,288,830	1,696,710

Note 1 - Stock exchange(s)

We have assumed that the Beirut Stock Exchange, although it will have to apply for authorisation under the Law, will not be required to pay an initial licensing fee as it is an already established exchange. However, we have assumed that during 1999 a second exchange will be established for the purposes of trading other financial instruments (possibly currency, securitised debt, interest rate and other products). We have assumed an initial licensing fee of US\$100,000 and an annual fee of US\$50,000.

Note 2 - Public offerings

The National Council will charge a fee payable by issuers based on the amount of money sought to be raised in Lebanon. This fee is set at 0.2 per mil with an upper ceiling of 5 times the minimum annual wage (US\$3,000 x 5). We have categorised the issues as small (average amount raised US\$6,000,000), medium (average US\$20,000,000) and large (in excess of US\$75,000,000).

We see strong potential for Lebanon in terms of a market for start-up and small venture capital companies, particularly from the Arab world, who will wish to raise capital in Lebanon and list their shares on the Beirut Stock Exchange. However, it will require time to establish such a market which will face opposition principally from Istanbul and Malta, and to a lesser extent from AIM in London. We have assumed that the market would not start until the second quarter of 1999 and will take 12 months to achieve prominence (AIM took 9 months and EASDAQ in Brussels took 12 months). In addition, we expect Lebanese banks and other local companies, particularly from the leisure and insurance industries, to raise additional capital via the stock exchange. Our assumptions are that:

- during 1998 there will be 4 small, 8 medium and 1 large issues;
- during 1999 there will be 8 small, 12 medium and 2 large issues;
- during 2000 there will be 20 small, 16 medium and 3 large issues.

Note 3 - Document vetting

Our calculations are based on the number of existing and new companies listed or publicly traded and the fact that, apart from annual accounts, companies on average only issue a circular to shareholders which would require National Council approval once every three years. We have assumed that this charge does not include issues by way of public offerings as this service will be covered under the charge for public offerings. Our estimates are based on a fee of US\$3,000 per document regardless of the number of drafts that may be submitted.

Note 4 - Brokerage and portfolio management firms

We have assumed that companies already licensed by the Banque du Liban will not pay an initial licensing fee to the National Council. We have assumed that there will be 5 new licences granted in 1998, 10 in 1999 and 15 in the year 2000. We have assumed an initial licence will be US\$25,000 with \$10,000 for renewal of a licence.

Note 5 - Collective investment schemes

With the personal and private pensions market expected to grow dramatically over the next five years (largely as European governments struggle to maintain state pension levels for Europe's ageing population), it is thought that there will be an increasing number of pension funds, many of which will be seeking a listing on an exchange. Most of this business is expected to go to Guernsey, Jersey, Dublin, London and Luxembourg with some finding its way to Bermuda,

the Cayman Islands and other off-shore financial centres. In addition, "trusts" business continues to grow year on year and this growth is expected to continue in the next 5 to 10 years. Our assumptions are based on the belief that there will be a small number of local/regional funds formed in Lebanon commencing in the second half of 1998 and that the goal for the development of Lebanese financial markets of establishing a Regional International Market to compete for international securities business against other financial markets will include competition for non-regional funds business; the first of this business coming during the second quarter of 1999. This is an extremely competitive market and although costs are not a major factor in determining where funds business will be located, charges have been driven down to extremely low levels. Although Article 13 specifies the annual fee to be charged, we have based our calculations on two of the world's largest investment fund centres, Guernsey and Dublin; whose charges for initial and annual registration are approximately US\$2,500 per scheme.

Note 6 - Individuals

Our assumptions are based on the premise that all persons conducting "securities business" in Lebanon will require to be licensed and that each licensed firm will have, on average, 10 licensed persons. We have also assumed a natural growth in the market of 10% per annum. Our calculations are based on an initial licensing fee of US\$50 per person with an annual renewal of licence at US\$20.

Note 7 - Examinations

Our assumptions are based on the premise that all persons conducting "securities business" in Lebanon will require to pass a securities industry examination or be exempt from the examination because of prior experience. We have assumed that 10% of all licensed persons will be granted exemption although it may be necessary for them to pass a competency test on the new Law. Our calculations are based on a charge of US\$50 per examination.

Note 8 - Training institute

We have assumed that the National Council will want to accredit a training institute to carry out the function of training licensed persons. We have also assumed that a second training institute will be accredited during the year 2000.

Note 9 - Search fee

The National Council will charge a small fee to anyone requesting a search of a register maintained by the National Council. We have assumed 10 searches per annum at US\$20 per search.

Net position over three years

	Lebanese pounds '000	Balance Lebanese pounds '000
Initial capital injection (Article 13)	15,000,000	15,000,000
Start-up costs	- 954,150	14,045,850
Deficit in the year 1998	- 1,471,754	12,574,096
Deficit in the year 1999	- 1,212,229	11,361,867
Deficit in the year 2000	- 1,023,867	10,338,000

CHAPTER 4 - REGULATORY DEVELOPMENT

In identifying and allocating priorities to the drafting of bylaws, rules and regulations, we undertook a review of the English translation of the current draft of the Law dated 20 April 1997. Following this review, we submitted comments to Dr. Nasser Saidi on various aspects of the Law. At subsequent meetings, it was agreed that our suggested amendments, including a Definition of Securities, should be incorporated into the next revision of the draft Law. During the drafting the bylaws it will be necessary to include in each of the bylaws other definitions or interpretations e.g. "acting in concert", "associate", "control", "dealing in securities" etc.

In reviewing the draft Law, we have identified and given priorities to each of the required bylaws, rules and regulations. Those with the highest priority are:

1. Stock Market Bylaws:

Stock Market

- restrictions on establishment of financial markets unless approved by the National Council;
- publication of notice of approval in the Official Gazette;
- transactions that may be conducted on an exchange;
- licensing requirement for a member/shareholder of an exchange company;
- duties of the exchange company;
- rules of approved exchange companies, including rules on membership, trading rules, listing rules, code of conduct to be approved by the National Council;
- approval of amendments to rules of an exchange company;
- appointment of Chief Executive to be approved by the National Council;
- withdrawal of recognition of an exchange company and directions to close facilities;
- closure of market in emergencies;
- prohibition of transactions during closure of market; and
- restriction on use of titles relating to exchange.

Trading

- control of off-exchange transactions;
- cold calls, hawking of securities;
- stock borrowing and lending;
- short selling;
- market manipulation and deceptive practices; and
- beneficial ownership of securities and other financial instruments.

The above provisions are generally found in the securities laws of most countries, including United Kingdom, Hong Kong, Australia, Sri Lanka and the draft law of the Peoples' Republic of China. The most contentious provision could be the one governing beneficial ownership and extensive consultation will be required at the time of drafting.

2. National Council of the Financial Markets Bylaws:

The bylaws should cover matters relating to the National Council such as:

- remuneration of board of directors;
- staff of National Council;
- power of National Council to establish sub-committees;
- delegation of the National Council's functions to sub-committee, director, or employee;
- requirement on the National Council to keep proper accounts and records;
- requirement on signing of statement of accounts;
- assistance to overseas regulators;
- secrecy provisions and code of conduct for National Council; and
- restriction on use of confidential information.

These are standard provisions governing the behaviour of regulatory authorities which have a public duty to the investing public.

3. Market Intermediary Bylaws:

The bylaws will cover matters relating to licensing of market intermediaries, and compliance requirements imposed on them.

Licensing

- types of market intermediaries requiring licensing;
- information required from applicants;
- matters affecting the National Council's determination of application;
- keeping of register of licensed persons by Council;
- waiver or modification of requirements;

Finance, Books and Records

- capital and liquidity requirements;
- failure to comply with financial requirements;
- submission of returns and annual audited accounts;
- keeping of books, accounts and records;
- issue of contract notes and statements of accounts to clients;
- segregation of clients' funds;
- responsibility of auditor to communicate with the Council in certain cases;

- monitoring of compliance by Council: power to appoint auditor and to conduct inspection visits.

Business Conduct

- business conduct rules may be made by Council;
- advertising; and
- fiduciary accounts maintained by licensed persons.

The provisions listed above are commonly adopted in the securities law of most countries. There may be concern on the part of the auditing profession on the proposed reporting requirement imposed on them in the event that they become aware of certain matters e.g. failure to comply with financial requirements, but this is a generally accepted requirement in most countries, including UK, Hong Kong, and Sri Lanka.

The Stock Market and Market Intermediary bylaws are time critical in that stock markets and market intermediaries have only six months from the date of the publication of the Law to comply with the new bylaws. The Stock Market bylaw is the most urgent and work should commence on this as soon as possible. However, with regard to the Market Intermediary bylaws, we recommend that if these cannot be introduced in time to allow intermediaries to register within the six month period, the National Council adapts and adopts Banque Du Liban circular 6213 on the Establishment and Activities of a Lebanese Brokerage Firm, together with the Bank's registration forms etc., suitably amended, until such time as the bylaws can be introduced.

The following bylaws, rules and regulations are regarded as medium priority and should be completed by end February 1998:

4. Bylaws on Listed Companies:

The bylaws will cover:

- requirement to comply with the listing rules of the exchange;
- requirement to publish information for the protection of the investing public;
- power of exchange to refuse application for listing;
- conditions for temporary suspension of listing or cancellation of listing;
- methods of bringing securities for listing;
- requirement for prospectus or listing particulars;
- responsibility statement;
- admission of a company listed in another country, its continuing obligations;
- continuation obligation of listed companies, including general obligation of disclosure for companies, notification of major interests in shares, communication with shareholders;

- disclosure of holdings of directors and major shareholders;
- purchase of own securities;
- directors' responsibilities and notification of interests of directors and connected persons;
- requirements relating to transactions with related parties, including transaction between a company, or any of its subsidiary undertakings, or a substantial shareholder (substantial shareholder to be defined);
- financial information required to be included in listing particulars and circulars; and
- other financial instruments to be listed.

The above are internationally accepted provisions governing public listed companies, their directors and substantial shareholders.

5. Takeovers and Mergers

The objective of these bylaws is to ensure fair treatment for shareholders who are affected by takeovers. The bylaws should be in keeping with international standards and should apply to all takeover transactions affecting public companies in Lebanon, whether listed or unlisted. They should seek to achieve fair treatment by requiring equality of treatment of shareholders, requiring the disclosure of timely and adequate information to enable shareholders to make an informed decision as to the merits of an offer and ensuring that there is a fair and informed market in the shares of companies affected by takeover transactions. The bylaws will cover:

- general principles, including:
 - limitations on directors' actions;
 - equality of treatment;
 - information to shareholders;
 - full and prompt disclosure;
 - no frustration of offer by offeree board.
- specific rules, including:
 - offers;
 - independent advice;
 - announcements;
 - obligations of directors;
 - timing and content of documents;
 - standard of care and responsibility;
 - profit forecasts and asset valuations;
 - issuance of documents;
 - offer timetable;
 - restrictions on and disclosure of dealings;
 - mandatory offer.

6. Investigation Regulations:

The following investigation provisions are basic requirements to enable the National Council to discharge the duties conferred upon it in Part Four of the Law concerned with violations and disputes. These provisions follow closely those adopted in UK and Hong Kong. They are:

- inspection of books and records of licensed persons;
- power to require production of records and documents concerning listed companies;
- power to investigate transactions;
- retention of documents by National Council for investigation;
- requirement to provide information on dealings to Council;
- failure to produce documents by person under investigation;
- production of computerised information; and
- destruction, falsification, concealment or disposal of documents.

7. Financial Markets Investor Guarantee Fund:

The ambit of the bylaws are basically defined in article 17 of the Law. They are reproduced below and expanded to cover related matters:

- define relationship between the fund and the board (possibility of a committee);
- money constituting the fund;
- object of the guarantee fund;
- the risks covered by the fund;
- claims against the fund and determination on claims;
- entitlement to the fund (e.g. members' losses not to be covered) ;
- ceiling of the guarantee;
- provision where fund is insufficient to meet claims or where claims exceed total amount payable;
- replenishment of fund; and
- investment of fund.

Those of a low priority are:

8. Entities of Collective Investment in Securities and Financial Instruments Bylaws:

The bylaws will cover:

- definition of collective investment in securities and financial instruments;
- authorisation procedures;
- structure and operation of a collective investment scheme;
- role of trustee/custodian;
- role of management company and auditor;
- pricing, issue and redemption of units/shares;
- transactions with connected persons;
- advertising and public announcements;
- reporting requirements to unit/shareholders and the National Council;
- fees;
- investment limitations;
- specialised schemes; and
- requirements for non-Lebanon based schemes.

These are basically the requirements in Hong Kong where there is a large market of investment funds.

9. Disciplinary Proceedings Bylaws:

The bylaws are to be made under article 23 by the Disciplinary Committee for the discharge of its functions imposed upon it by article 24. The presence of these rules are necessary to ensure that all disciplinary proceedings of the Disciplinary Committee are conducted in a fair manner. The suggested provisions are in line with the Disciplinary Rules and Procedure of The London Stock Exchange. The rules should cover, amongst other things:

- duties of Disciplinary Committee;
- disciplinary procedure;
- procedure at hearing;
- legal representation;
- admission of evidence;
- findings;
- notification of findings;
- appeal against findings;
- appeal against findings and penalty; and
- statement by Disciplinary Committee.

In addition, to drafting the above bylaws, consideration will have to be given as to whether there should be a bylaw on insider dealing or whether this will require primary legislation.

We also identified and assigned priorities to the drafting of guidelines, manuals and code of conduct of the National Council, stock exchanges and market intermediaries as follows:

- a) **Handling of complaint procedures** - medium priority
- b) **Investigation procedures** - medium priority
- c) **Guidelines for audit of brokerage firms** - medium priority
- d) **Arbitration procedures** - low priority
- e) **Code of conduct for market intermediaries** - low priority

In compiling and drafting the necessary bylaws, rules and regulations, we recommend the following approach:

- a) The appointment of a small team who will assist the consultant in the drafting process. This team should comprise people who can debate the policy, strategy and procedural aspects of the National Council and the Lebanese financial markets, together with a local legal drafts-person(s);
- b) The consultant will discuss, with the team, the elements and issues surrounding each of the bylaws and begin to put together the framework for the bylaws;
- c) The consultant will prepare the initial drafts of the relevant bylaws containing all the necessary elements; concentrating first on those of a high and medium priority;
- d) The team will review the draft bylaws and ensure, by way of further discussion and dissemination to a wider audience, that the drafts conform with Lebanese practices and procedures;
- e) The consultant will review the draft bylaws produced by the team to ensure harmonisation and compliance with international standards;
- f) The National Council will implement and publish the relevant bylaws.

A plan of activities to draft those bylaws, rules and regulations which are regarded as high and medium priority and which should be completed by end February 1998 is set out in Annex D.

CHAPTER 5 - PROCEDURAL DEVELOPMENT

Premises Location

We have assumed, for the purposes of budgeting and planning, that the offices of the National Council will be located in the Aresco Centre in the Hamra district of Beirut and that the National Council will rent and not own its premises. The Aresco Centre is a modern high rise building close to the Banque Du Liban and houses the Banque Du Liban's International Affairs Department and Financial Markets Department on the 14th floor. MidClear has its offices located on the 15th floor.

Premises Requirements

The requirement is for a secure, modern or refurbished building to house the offices of the National Council, its directors, staff and computer systems. The style of the premises should be in keeping with the standing of the National Council.

Requirements

- Well appointed building
- Good security
- Good communications
- Close to the financial centre of Beirut
- Offices for directors
- Offices for staff
- Directors board room
- Private meeting rooms
- Computer suite (Note*)
- Storage facilities
- Car-parking

Note*: Standby generator and UPS for the computer suite is not essential but could become desirable when the Surveillance Systems go "on-line".

Accommodation Requirements (for budgeting purposes)

- Office for the Chairman
- Office for the Deputy Chairman
- Board room
- Two meeting rooms
- Office space for 3 staff from the Market Supervision Department
- Office space for 2 staff from the Corporate & Legal Affairs Department
- Office space for 2 staff from the Securities Institutions Department
- Office space for 4 staff from the Administration Department

- Computer Suite
- Storage Space

Rental Negotiations and Fitting-out

The plan (Annex E) assumes the identification of suitable premises and preliminary discussions taking place with the landlord prior to the establishment of the National Council.

During the period up to the formal establishment of the National Council, temporary premises will be required by the consultant and the project team.

Once suitable premises for the National Council have been identified and a lease signed with the landlord, there will begin a period of space planning, fitting-out, ordering of communications lines, office furniture, equipment and their installation in time for the formal work of the National Council to begin. The computer suite should be secure, have a false floor, its own separate and secure power supply as well as halogen gas in the event of fire. For the purposes of budgeting, it has been assumed that only the offices, board room and the two meeting rooms will be carpeted.

Administration

Prior to the formal establishment of the National Council, it will also be necessary to identify and plan for its needs in terms of general office computer equipment and software e.g. word-processing, staff payroll records etc. Stationery will have to be designed and printed and other office consumables purchased etc.

It is recommended that, at the earliest opportunity, the person who will undertake the role of Head of Administration at the National Council should be appointed to manage the location and equipping of the premises.

CHAPTER 6 - ADMINISTRATIVE DEVELOPMENT

PART A - REPORTING RELATIONSHIPS AND MANAGEMENT FUNCTIONS

Chapter 2 describes the functions, responsibilities and powers of the National Council concerning the regulation of the financial markets. It also outlines the organisation required for the efficient and proper discharge of its duties.

Part A of Chapter 6 seeks to:

- identify the various parties, both internally and externally, that are involved in the regulation of the financial markets and related activities;
- propose effective reporting relationships and management functions within each department of the National Council, between the departments, and between the Office of the National Council and the Board of Directors;
- identify relationships between the Office of the National Council, the Board of Directors, the Disciplinary Committee and the Court of Financial Markets;
- recommend co-ordination between the National Council and other external agencies involved in different aspects of the financial markets in Lebanon, including the Banque Du Liban and specifically its Banking Control Commission, the Tribunal of Commerce, Law Enforcement Agencies; and
- identify the status of the National Council within the overall Government structure

Reporting Relationship Within Functional Departments

There are four functional departments in the office of the National Council, each headed by a manager. Two departments (Corporate & Legal Affairs and Administration) report directly to the Chairman whilst the Market Supervision and Securities Institutions departments report to the Deputy Chairman. The Deputy Chairman, in turn, reports direct to the Chairman. The manager of each department has supervisory responsibility over the activities of his department. There should be a detailed job description in place for each post, including specific reporting responsibilities. Procedural guidelines need to be drawn up to define the decision making process and level of authority. Regular staff meetings should be held at least weekly for all the units within the department, to identify problems, exchange views and opinions, co-ordinate activities, and report on progress.

Interaction Between Functional Departments

It is of utmost importance that there is constant interaction between the various departments at all levels and at all times, to ensure that there is a concerted effort in the discharge of regulatory responsibilities. It must be recognised that the work and information available to one department or a unit in a department

would be useful to another department, and that such information must be shared within the office as much as possible without delay. To quote an example, the surveillance officer should immediately alert the officer dealing with listed companies' continuous compliance of any unusual activity in respect of share trading detected through the surveillance system, in addition to reporting to his department head. Likewise Public Offerings and Continuous Compliance should be able to comment on and influence the stock watch list of the surveillance officer. The Department of Securities Institutions needs to work closely with the Enforcement team in areas of investigations into allegations against licensed persons.

The procedural guidelines should identify work areas requiring inter-departmental co-operation and recommend appropriate and effective procedures.

In addition, there should be regular weekly meetings of department managers, chaired by the Chairman or Deputy Chairman so that the Chairman and senior management of the National Council are kept up-to-date with the work of the office and any problems that may have arisen in the course of the discharge of duties by the departments.

Relationship Between the Office of the National Council and the Board of Directors

The Administration Department will be responsible for providing administrative support to the Board of Directors, arranging meetings, co-ordinating papers for discussion, acting as secretary to the Board at meetings, and disseminating Board decisions to the respective functional departments.

Each department is responsible for preparing papers for deliberation by the Board in respect of matters within its purview and, where necessary, to present joint papers. The department manager and, if appropriate, the subject officer are required to attend meetings of the Board to present their papers and to take part in the discussions.

A monthly management report should also be presented to the Board to keep members abreast of the activities that have taken place in the office. The Administration Department will be responsible for co-ordinating inputs into the report from all departments.

Relationship Between the National Council, the Disciplinary Committee and the Court of Financial Markets

The Disciplinary Committee is established at the National Council under article 22. It has the power to set its own bylaws and the Council bears all its expenses. The Chairman of the National Council is the Chairman of the Disciplinary Committee by virtue of article 22. Any violations of laws, regulations and instructions by the stock market administrations and by companies and entities

which are members of these markets are transferred to the Committee. Article 24 confers upon the Disciplinary Committee the power to impose administrative sanctions.

In essence, the Disciplinary Committee is the disciplinary arm of the National Council, having full rights and responsibility to assume the statutory functions as contained in the Law, independent of the Board of Directors. It will receive administrative support from the office of the National Council. The Enforcement Unit of the office will act as prosecutor in cases referred to the Disciplinary Committee.

Given that the Chairman of the National Council is also Chairman of the Disciplinary Committee and that one of the directors of the Disciplinary Committee is a member selected by the Board of Directors from its membership, it is important that they should not be prejudiced by events or decisions taken at meetings of the National Council. Therefore, they should not receive relevant National Council papers and should abstain themselves from any discussions at National Council meetings on cases that may be referred to the Disciplinary Committee.

Whilst the Disciplinary Committee is independent of the Board of Directors in its actions and decisions, it is considered appropriate that a summary report on the actions taken by the Disciplinary Committee against licensed persons or stock market administrations be made to the Board of Directors by the relevant Department.

It is recommended that there should be appeal provisions against the decision of the Disciplinary Committee, and this should be contained in the Law.

The Court of Financial Markets is a special legal commission established under article 27 of the Law, with specific functions to look into disputes arising from operations carried out in the financial markets which were not settled by the market regulations, as well as the violations transferred to it by the Board of Directors on cases of market manipulation as defined under article 20. The relationship between the Court of Financial Markets and the National Council is therefore that of a court and the prosecutor.

There should be provisions for appeal against the decision of the Court of Financial Markets and this should be contained in the Law.

Interaction Between National Council and Other Regulatory Agencies

Other regulatory agencies that may be involved from time-to-time in various aspects of the Lebanese financial markets are:

- the Banque du Liban
- the Tribunal of Commerce, and
- the Police Department, in particular, the commercial crime bureau (should one exist).

In addition, the National Council will need to establish relationships with foreign securities market regulatory bodies either through membership of international organisations such as IOSCO, or via a specific agreement or Memorandum of Understanding with, for example, Kuwait and Egypt on dual listings.

The Banque du Liban

Currently, The Law No. 520, Development of Financial Markets and Fiduciary Contracts, dated June 6, 1996 together with supporting regulation, "Decisions number 6213 Related to Brokerage Firms" places the responsibility for the regulation of brokerage firms under the control of the Central Bank's Banking Control Commission. Also, an applicant for membership of the Beirut Stock Exchange must first obtain a licence from the Central Bank as a "Financial Institution" and/or as a Brokerage Firm.

These functions will be assumed by the National Council upon the enactment of the Law of Financial Markets. It is important that there should be co-operation between the two regulatory bodies during the transitional period.

The Lebanese financial markets are going through a period of change. Given the potential growth of investments in Lebanon, the development of new market instruments and the involvement of investment banks, commercial banks and foreign financial institutions in the financial markets of Lebanon, it is important that there is interaction between the National Council and the Central Bank to ensure that there are clear lines of responsibilities and to avoid the risk of duplication of effort. The involvement of the Central Bank by the appointment of one Vice Governor on the board of the National Council would assist in defining policies particularly in areas of common interest.

The Tribunal of Commerce

The Tribunal of Commerce is responsible for the registration of companies, including joint stock companies, and public companies which may be traded on the stock exchange or the OTC market. However, it is important that there is a continuing dialogue between the National Council and the Tribunal of Commerce on matters relating to the administration of such companies, both at policy level and on specific cases. This will ensure uniformity of standards and avoidance of duplication, e. g. in the case of investigations into activities of directors of public listed companies. The interaction could be by way of meetings and where necessary by inviting representatives from the Tribunal of Commerce to attend meetings of the Board of Directors on particular issues as permitted under article 9 of the Law.

The Police

It is envisaged that in areas of enforcement, the Enforcement Unit of the National Council may be required to co-operate with law enforcement agencies, particularly in areas of commercial crime or securities fraud.

Experience in other countries is that local law enforcement agencies, and sometimes the Courts, do not have experience or expertise in investigating or handling securities fraud cases. It is in the interests of the investing public that both the National Council and the law enforcement agencies build up that expertise for the proper discharge of their duties. Constant interaction through meetings and exchange of views is an effective way to work towards this.

It is important, however, that procedures both within the office of the National Council and between the National Council and law enforcement agencies are in place to ensure that disclosure of information and facts are treated with extreme caution, having regard to the secrecy provision imposed on the National Council as contained in article 34.

Relationship Between the National Council and the Government

Under article 5, the National Council is administered by a Board of Directors. The Chairman and Deputy Chairman are appointed by decree of the Council of Ministers upon the proposal of the Minister of Finance. The National Council has an independent budget which is required to be published in the Official Gazette (article 13 c). It is also required (article 12.6.f) to submit its annual report to the Council of Ministers and to publish it in the Official Gazette.

The National Council is therefore an independent statutory body with certain statutory powers to regulate the financial markets. It goes without saying, however, that in situations that may affect the economy and stability of the country as a whole, the National Council, being a responsible body, will report and seek guidance from the Council of Ministers.

PART B - SURVEILLANCE SYSTEM FOR THE NATIONAL COUNCIL

Functions of the system

As the front-line monitor, the Beirut Stock Exchange will be responsible for monitoring its own trading systems and the activities of its members relative to its own trading rules. However, as the lead regulator, the National Council is responsible for the overall performance of the market. This will be achieved through the development and implementation of an array of systems and procedures. Central to this will be the market surveillance system which may ultimately include the provision of on-line risk management modules.

The surveillance systems of the National Council should be capable of analysing information and data from stock markets, market intermediaries, the central clearing and depository system, listed companies, company registrars, investment funds, and other market sources for the purpose of investor protection in its widest context. This will often include:

- analysing trade and other data from a stock market and other sources in order to investigate alleged cases of insider trading or market manipulation;
- analysing financial information from market intermediaries to ensure

- compliance with minimum liquidity requirements;
- maintaining information on licensed and non-licensed firms and persons;
- ensuring timely and accurate release of company information; etc.

The principal feature of a regulatory market surveillance system is the central database of information which can be interrogated by the Surveillance Department of the National Council. This database will be constantly updated with new market and other data. Interrogation and report generation will normally happen on a next day or following days basis but the system should ultimately allow for on-line analysis, particularly of market data. This would be particularly important in instances of sharp movements in volatility in which case the Surveillance Department may wish, through time, to run risk management modelling tools in order to monitor or control brokers' exposure to the market. Certain reports will be specified and produced on a regular and pre-defined basis, but there should also be the facility to create ad hoc reports. The system should allow for screen enquiry of information, for printing and for downloading to another system.

Although the National Council can heavily influence the way in which information is submitted to its system it cannot dictate what systems or communications mediums the financial markets must use. Therefore, the system must be flexible in the way in which it accepts information into the database and, where necessary, reformat the data for its own purposes. Obviously, security of data and restrictions on access are of paramount importance.

The current trading system used by the Beirut Stock Exchange will be one of the prime providers of market data. As it is likely to be re-developed or replaced at some stage in the future, it may be necessary and/or advisable to phase the development and implementation of the regulatory surveillance systems to cater for the BSE's new trading system. Described below are some of the features that we would expect to see in a phased development:

Phase One

Information supplied in written form or on computer disk and re-entered into the surveillance system for later interrogation. Such information would include market data, information from the central clearing, settlement and depository system, information on or about licensed intermediaries, investment funds, licensed persons and, company information.

Phase Two

The automation of the links between the systems of the BSE, Midclear and the National Council's surveillance system. Ultimately, it may be possible and desirable to provide automated links with licensed market intermediaries but this should be looked at in the longer term. Generally, securities regulators do not have direct links to listed companies except where there is a central register and even then only if the law enables the sharing of information. It will

therefore be necessary to determine what information can be sought or obtained from Midclear before giving thought to the development of a link between the surveillance system and Midclear's systems.

The types of information reports that the surveillance system will generate could include:

Market Information

- the performance of an individual stock price over a specified period together with high and low trade prices and opening and closing prices;
- a record of all order entries showing security, order price (if entered), order type, quantity of order, name of member firm, whether buyer or seller, whether principal or client order and time of order input;
- a record of all trades showing security, price, quantity, name of buying firm and whether principal or client, name of selling firm and whether principal or client, and time of trade;
- order and trading volume for a particular security by day and over a period;
- trading activity of all member firms by security, split into principal and client account dealings;
- ad hoc reports on specific order or trading patterns by member firm, market sector or the market as a whole.

Market Intermediaries

- information on licensed market intermediaries e.g. name of firm, address, telephone and fax numbers, e-mail address, scope of activities, membership of markets, names of directors and senior executives, names of employees, auditors, bankers, date of incorporation, date of registration, year end, etc.
- financial reports on market intermediaries e.g. capital requirement, minimum liquidity requirement, allowances agreed against minimum liquidity position, actual capital and liquidity positions, date of last financial report, date of next financial report due;
- date and details of last surveillance visit, date of next visit (if scheduled);
- ad hoc reports on any aspect of the information contained in the database relating to licensed market intermediaries;

Custodian and Clearing Centre

- information relating to Midclear and its officers;
- date and details of last systems and operational audit, date of next audit (if scheduled);
- standard reports designed to ensure that all trading is conducted through the Beirut Stock Exchange;
- ad hoc reports in respect of information supplied by Midclear in cases of suspected insider trading or market manipulation.

Company Information

- name of company, address etc., where incorporated, date of incorporation, activity, names of directors, senior managers, auditors, legal advisers, brokerage firm, year end, date of latest annual accounts, when next accounts due, capital, shares in issue, date of last prospectus, date and details of last issue of shares, details of any financial forecast given, details of any directors or major shareholdings, etc.
- ad hoc reports in respect of information supplied by companies in cases of suspected insider trading or market manipulation.

Implementation Plan

The following steps are required:

1. Review current trading system of stock exchange, trading rules, current available data on listed companies and brokers on the stock exchange system;
2. Review current clearing and settlement system of the Clearing Company, its rules, and relationship with the exchange. Particular emphasis should be placed on risk management control and cash control;
3. Study the proposed new trading system of the exchange and its specification, if available;
4. Study changes, if any, required to be made to the clearing and settlement system in light of any new trading system;
5. Discuss and finalise systems requirements of the National Council for surveillance of the market;
6. Assess the National Council's overall systems requirements - central database for licensed persons, finance and accounts, listed company information, and determine the capacity of the surveillance system;
7. Prepare a system requirements specification;
8. Finalise sources of funding;
9. Issue tender invitation and award of tender;
10. System installation;
11. System testing; and
12. Operation.

Schedule

Planning: (Step 1 to Step 7) - Six weeks (elapsed time)

Installation: (Step 8 to Step 11) - Six to eight months (elapsed time)

Start date: (Step 12) - Eight to ten months following the commencement of the planning stage.

Ideally, the Planning Stage for the surveillance system should not commence until all the bylaws and procedures are in place and until the new systems of the Beirut Stock Exchange have been specified, thereby avoiding constantly changing the requirements. The use of a temporary system also provides an opportunity for staff of the Surveillance Department to gain experience and to be better able to define their requirements. However, it is important that any temporary system is replaced at the earliest opportunity. On the basis of a November 3 start date for Phase 1b of the Project, the consultant expects to complete the Planning Stage for the surveillance system by 31 March 1998 and on this basis it is possible that a new surveillance system could be operational by September 1998.

PART C - ENFORCEMENT FUNCTIONS

Under the Law, the National Council is required to protect the savings invested in securities and financial instruments for the purpose of promoting investments in the financial markets. It is charged with the responsibility of enforcing compliance with the Law and regulations governing exchanges and their members, the custodian and clearing company, listed companies and other market intermediaries.

The purpose of this Chapter is to highlight the key issues relating to the enforcement functions, operational procedures and systems required of the National Council.

Stock Exchanges and the Custodian and Clearing Centre (Midclear)

The National Council's enforcement of compliance over the stock exchanges, their members and Midclear should take the following forms:

- review of the constitution, structure and management structure, including the rules, finance and staffing etc.;
- review of supervision by the exchanges of their members;
- review of operational areas in trading, clearing, settlement and custody;
- review of supervision by exchanges of listed companies;
- inspection visits to exchanges, their members' offices, and Midclear.

The National Council needs to draw up **check lists** for the above work to enable its staff to ensure systematic compliance of the regulations by the institutions and their management.

Because the Law requires that all trading in Lebanese securities (in Lebanon) is required to be conducted on-exchange, procedures will be required to ensure compliance with the Law. It has been assumed that Midclear will undertake responsibility for the share registers of all listed and publicly traded securities. However, it has still to be ascertained whether Midclear has (a) the power to force all companies to move their share register, and (b) the capacity to handle the business. This will be ascertained during the task to draft the bylaws for the

custodian and clearing centre.

Securities Brokers and Market Intermediaries

Although stock exchanges are responsible for front-line monitoring of members' activities this should not include financial supervision but be restricted to trading and compliance with the rules of the exchange. The National Council will be responsible for all financial supervision over members of stock exchanges and over non-member brokers.

The National Council should receive and examine returns and audited accounts of member and non-member brokers. A **check list for vetting of financial reports** should be drawn up to maintain uniformity of standards.

Also, submission of returns in computer form should be explored as this has the advantage of immediate availability of information and allows analysis to be conducted automatically. The Market Intermediary Bylaws should make provision for this.

There should be a clear programme of **regular inspection visits** to member and non-member brokers' offices.

There should be **audit/inspection guidelines** to standardise the work required of the inspection teams. The guidelines should cover matters such as:

- pre-visit preparation check list, which should include matters like checking the scope of authority, past complaints or disciplinary hearings for current potential problems, and the audited accounts for qualifications;
- content of the audit/inspection, which should include checking of the management structure of brokers' office, branch offices and their control, financial position, internal control, control on segregation of clients' accounts from self-trading accounts, existence of a compliance officer, risk management, clients' agreements, brokers' self-trading accounts and control, nature and depth of testing etc.;
- follow-up work, including reporting to management and notification to brokers of areas requiring improvements, handling of rule breaches etc.

Proper planning and documentation of the audit/inspection review will help focus the inspector's mind on the task at hand and at best provide a comprehensive point of reference for the regulators. It also helps the inspectors to justify their recommendations and actions to both management and the brokers. From an internal viewpoint, comprehensive documentation is a useful management tool.

There should be a central registry in computer form in which information on assessment of the financial reports as well as the results of audit/inspections should be stored for reference of investigation and audit/inspection work. The information will help to build up a useful picture of a broker.

Market Surveillance

An integral part of enforcement work is monitoring trading on the securities markets with a view to detecting unusual movements in price or volume. These may indicate either possible insider dealing, market rigging, or price manipulation, and may require further appropriate investigation .

Apart from front-line monitoring by the exchange, the day-to-day surveillance of market trading should also be conducted by the National Council. The National Council which has the responsibility for supervising exchanges, requires the exchanges to report abnormal prices or volumes and to conduct share dealing investigation.

Information Gathering

The National Council is also responsible for gathering information about the securities market, including listed companies, securities dealers and investors. The National Council should monitor company announcements and news and gossip on market activities. It is essential that a **central data base** is established for the receipt and storage of information and data on listed companies.

There should be a system for storage of **information on securities brokers and intermediaries, including financial data and audit/inspection data**, referred to above. The data thus built up should provide useful information for future surveillance and investigation work.

There should also be **confidential data** concerning information on persons and companies with a sanction record or any person or company that has been investigated. This should prove particularly useful to the Enforcement Unit, but its access should be strictly controlled on a need-to-know basis.

Complaints Investigation

Receiving and vetting complaints from the public is part of the enforcement process.

A detailed **complaint investigation procedure** should be drawn up. The primary objective of any complaint system is to determine the truth of a matter so that appropriate action can be taken with promptness and efficiency. A secondary objective is the advancement of the image of the National Council because an effective complaint system will, over the longer term, generate a considerable amount of confidence and good-will.

The complaint investigation procedure should provide guidance on how to handle complaints received in writing, in person and by phone; anonymous written complaint; safeguarding the identity of a complainant; proper keeping of register of complaints; taking of statement and recording; follow-up contacts with a complainant etc.

Investigation

Investigation work covers enquiries into: alleged breaches of the Law and exchange rules and regulations; alleged misconduct of brokers and other market intermediaries; and market malpractice. The findings of the investigation may lead to disciplinary hearings and sanctions.

It is necessary to draw up detailed **investigation procedures**. It is recommended that these be drawn up as guidelines. The guidelines should address the stages and method of investigation, the recording of statements, the interview of witnesses and potential witnesses, the gathering of documentary evidence (exhibits), the number of staff to be present for each interview, notification of formal inquiry, the hearing process, and judgement. The existence of guidelines should achieve streamlining of the enforcement procedures, thus enhancing the efficiency and effectiveness of the performance of the National Council.

CHAPTER 7 - SKILLS DEVELOPMENT

Of primary importance to the success of the National Council is its credibility in the eyes of the securities industry both in Lebanon and overseas. We believe therefore that the first training programme should be addressed towards the Board of Directors and Heads of Department of the National Council. It should focus on the approach to regulation which, although simple in structure, should follow best international practice and be capable of modification by amendment, if necessary, to reflect the changing circumstances of a developing market. This should be followed by a further, more detailed, training programme to the new staff of the National Council and the Beirut Stock Exchange on the practicalities of regulation to enable them to be more effective in their jobs.

In constructing the overall design of a training programme for the National Council, we will stress the need for regulation in a developing market and lay particular emphasis on designing courses which deal with the functions, objectives and approaches to regulating the securities market.

The training and skills development programme will be the responsibility of the Resident Adviser, working together with the Manager, International & Training Department. The training programme will be designed to satisfy the individual training needs of the staff and will include:

- an interactive discussion with the Board and senior staff on the focus of regulation in Lebanon including comparisons with other financial markets;
- a general training programme to staff on the practicalities of regulation;
- specific training programmes designed to improve the skills of individuals;
- on-the-job training which will include involvement in the drafting of the bylaws, rules and regulations and the activities involved in establishing the National Council;
- foreign study tours and attendance at overseas regulatory training courses;
- the design and implementation of a securities market training programme linked to an industry qualification.

Regulatory Training: Phase 1

The first regulatory training will be delivered to the Board and senior management of the National Council, the Bank Du Liban, the Ministry of Finance and the Beirut Stock Exchange. The programme will place emphasis on the objectives and approach to regulation. This will help in the formulation of regulatory policy as well as the development of an understanding of the practicalities of regulation. The programme will cover the following subjects:

- the Law: its objectives and scope;
- the regulatory body: its role, functions and powers;
- interaction of regulatory bodies, internally, externally, and internationally;

- approaches to regulation of stock exchange, depository and clearing company, listed companies, the OTC market and market intermediaries;
- company disclosure, prospectus requirements, disclosure of holdings of directors and major shareholders, continuing obligations of listed companies, take-overs and mergers, responsibilities of directors;
- market supervision and market malpractice;
- the international scene: structure, approach and regulation; and
- best business practices, codes of conduct.

It is important that Phase 1 of the regulatory training takes place as soon as possible after enactment of the Law.

Regulatory Training: Phase 2

The second phase of regulatory training will be a more detailed training programme, to be held in two parts - Part A and Part B, for the new staff of the National Council and the Beirut Stock Exchange on the practicalities of regulation to enable them to be more effective in their jobs.

The course (Part A) will assist them in understanding the Law, the regulatory functions of the National Council, and more importantly, the skills necessary for the proper discharge of their duties. They will learn the proper concept of regulation and what is expected of them in the regulation of stock exchanges and their members, the custodian and clearing company, listed companies and other market intermediaries. The content of the programme will be similar to the programme for the senior management in phase 1, but there will be a difference in emphasis - phase 1 will concentrate on policy issues whereas phase 2 will be on the implementation/enforcement issues.

An extension of the phase 2 training (Part B) will be specific training programmes designed to improve the skills of individuals. In particular they will learn the skill relating to the enforcement functions, operational procedures, which include:

- technique on conducting inspection visits to brokers' offices;
- technique on examining financial and management returns from market intermediaries;
- market monitoring skills; and
- technique and procedures on handling complaints and conducting investigation.

Phase 2 (Part A) of the regulatory training should be held three months after the enactment of the Law, when the majority of the staff holding functional posts are in place. Phase 2 (Part B) should be held six months after the enactment of the Law when all the staff are in place.

The training programme should be for a total period of four weeks, with two weeks for Part A and another two weeks for Part B which should include a revision of Part A.

On the Job Training

It is proposed that a core unit comprising three persons, one of whom must possess legal qualification and experience to work hand-in-hand with the consulting team on the drafting of the bylaws, rules and regulations. The experience and training provided should prove invaluable to the Council staff in understanding the basis of the rules and regulations to be enforced by them.

The team should be in place one week prior to the drafting of the Law.

Securities Industry Training Program and Examination

The National Council has the duty to encourage and take initiative in organising securities industry training courses for market participants and staff of the National Council as part of the skills development program. This training course will enable the National Council staff and other market participants, including securities dealers, investment advisors and investment fund managers, to acquire the necessary knowledge and skills in matters covered by the Law. The course will also give them a more sophisticated view of their own jobs and organisations, and of the world markets generally.

The training programme will be repeated periodically, and subject to the agreement of the National Council, may lead to a securities industry examination and a qualification for all licensed persons. The training programme should be constructed using local experts, wherever possible, although initially it may be necessary to call upon the services of a limited number of foreign experts. The American University of Beirut could be involved in the development and operation of the training courses and the securities industry examination.

In establishing an industry qualification for market practitioners, consideration will have to be given to exemption, or at least partial exemption, to those who are already working in the securities industry. This could be achieved by exempting, or partially exempting, those people who hold an existing securities market qualification gained in another country, or those with extensive relevant working experience in the securities industry acceptable to the National Council.

It is considered appropriate that the first securities training programme should be held five months after the enactment of the Law, to be repeated every two months, depending on the number of market intermediaries that require training.

Discussions and policy consideration on the holding of securities industry examination should commence six months after the enactment of the Law with a view to finalising the arrangement by the end of one year.

Overseas Study Tours and Training Courses

National Council senior management will also benefit from study tours to US and other markets. These tours should include visits to stock exchanges and regulatory bodies in, for example, Cairo, Riyadh, Washington, Paris and London. Other Arab developing markets are included because the regulatory structure and stage of development of the markets is much closer to that of Lebanon thereby enabling participants to relate more closely to their own situation. Upon returning to Lebanon, study tour participants will be required to prepare a back-to-office report on the lessons learned and results achieved through the study tours.

When the participants in the study tours have completed these reports, plenary sessions will be held to discuss the reports and to pass on information to staff who did not participate but who would benefit from hearing about the tours.

In addition to study tours, staff will attend courses held in other major international capital market centres particularly the US Securities and Exchange Commission's Emerging Markets Course which would be of benefit to selected key personnel. Attendees will, like those on the study tours, be required to write reports on the courses and to disseminate the knowledge they have gained.

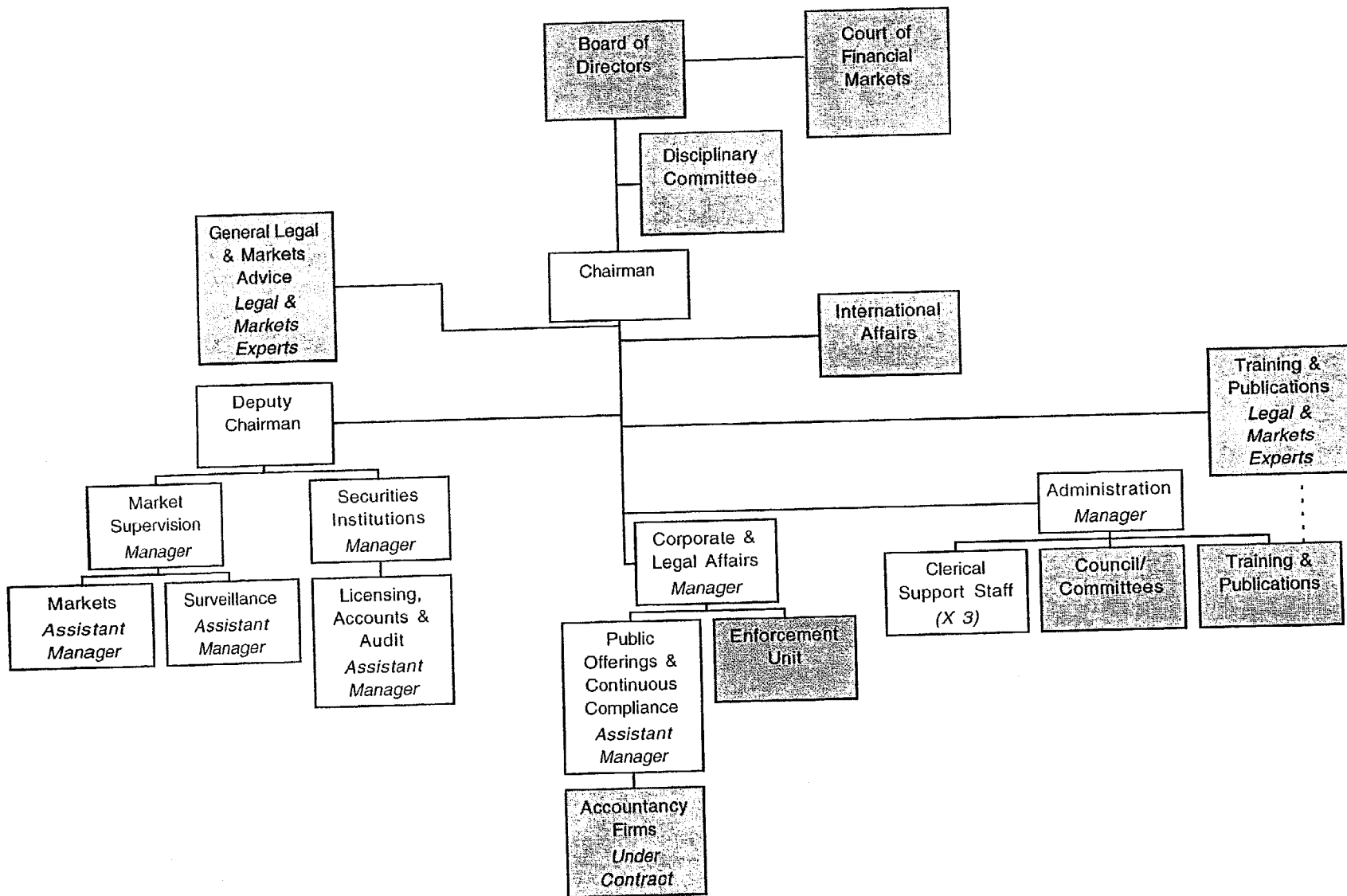
Education for Other Professionals and the Investing Public

The National Council with the assistance of the consultant, should also design and encourage seminars on the Law, market fundamentals and basic market operations. The seminars, which would be held throughout the year, would be targeted at the investing public, market participants and other professionals such as lawyers and accountants.

The Council should also, together with the stock exchange, organise educational and promotional campaigns to raise the awareness and interests of investors. This should be a priority for the head of the Department of International and Training of the Office of the National Council once in place.

In the longer term, the National Council should discuss with local universities and schools of higher education the introduction of courses and subjects on investment and capital market operations.

Annex F is a provisional plan aimed at scheduling a general training and skills development programme. The individual staff development programmes will be incorporated into the general training programme as necessary.



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Annex B

National Council Phasing-in of Staff

It is proposed that the staff of the National Council be taken on board in phases in line with the implementation of the Law and bylaws.

Phase I - The appointment of a Team to work on the bylaws

The appointment of a team from the Banque Du Liban, working with the consultant and under the control and supervision of Dr. Nasser Saidi, Vice Governor of the Banque Du Liban, on the preparation of the bylaws of the National Council. It is highly recommended that, wherever possible, members of the "team" should go on to be employees of the National Council.

Phase 2 - One month prior to the enactment of the Law

The secondment of additional people to the Team and the identification of members of the Team in the following roles:

Manager (Administration) to establish the Office of the National Council, to provide administrative support to the National Council at meetings as well as to perform executive work for the Chairman and Deputy Chairman.

Manager (Market Supervision) to review the constitution, bylaws, rules and regulations of the exchange company for the purpose of recommending to the Board of Directors of the National Council the granting, or otherwise, of the license to operate the stock exchange no later than six months from the publication of the Law as stipulated in article 35.

Manager (Securities Institutions) to implement the Market Intermediaries bylaws, in particular, the preparation of licensing forms and the vetting of applications to ensure that the requirement in article 37 that all companies and entities are licensed within a maximum period of six months of the publication of the Law can be met.

Assistant Manager (Markets) in the Market Supervision Department to assist the manager in establishing the procedures for the supervision of the Beirut Stock Exchange.

One clerical support

Phase 3 - Upon enactment of the Law

The appointment of the National Council and in particular the Chairman, Deputy Chairman, Markets Expert and Legal Expert.

Phase 4 -Three Months after Law Enactment

Assistant Manager (Licensing, Accounts and Audit Unit) in the Department of Securities Institutions to commence work on licensing of securities companies, investment advisors and their representatives, including examination of their accounts. They are also required to administer other provisions of Securities (Market Intermediaries) bylaws, such as maintaining public register of registered persons etc.

Assistant Manager (Surveillance) in the Department of Market Supervision to assist the manager in monitoring trading and in the design and implementation of the market surveillance system.

One clerical support.

Phase 5 - Six Months after Law Enactment

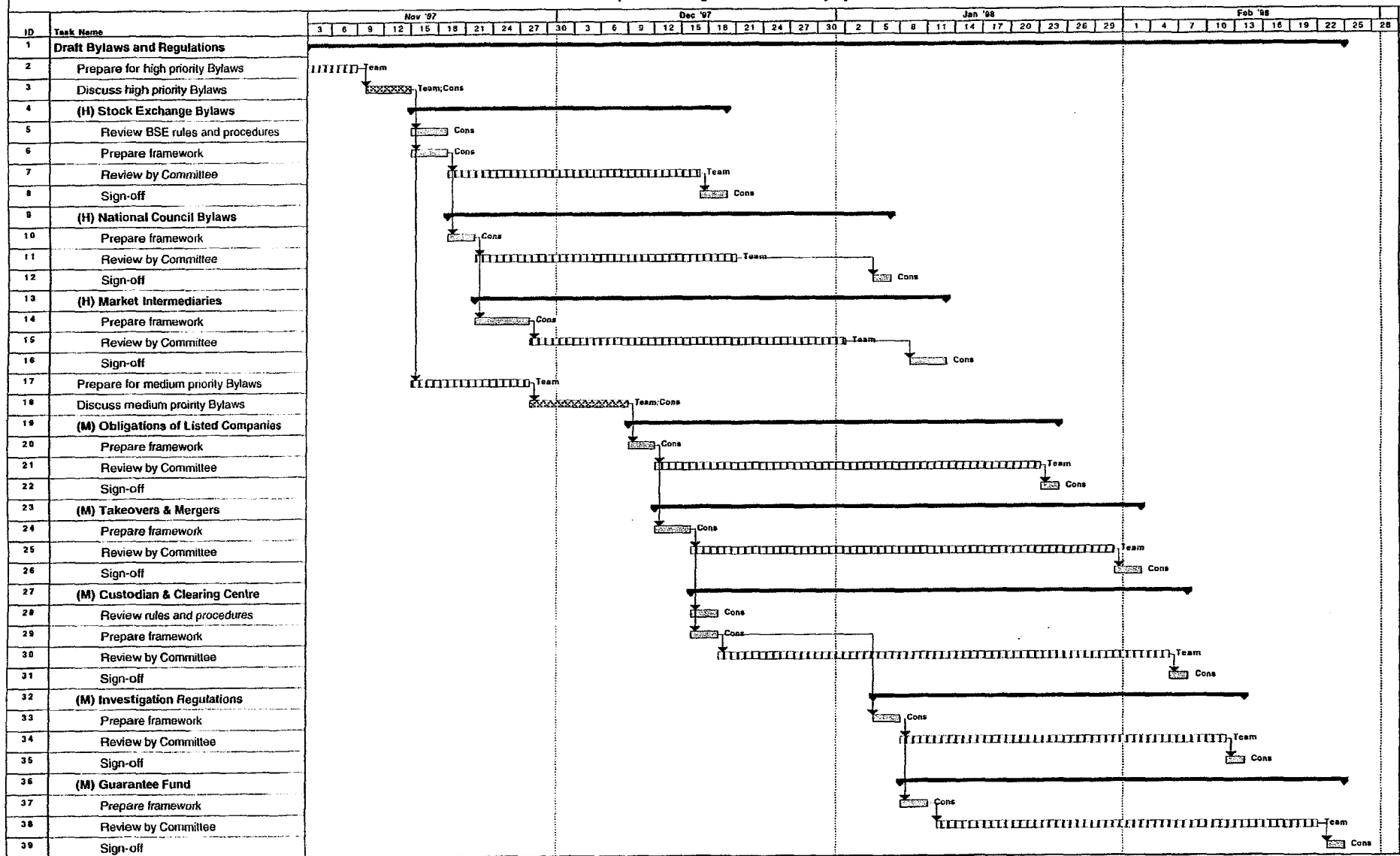
Manager (Public Offerings and Continuous Compliance) in the Department of Corporate & Legal Affairs to enforce the provisions of the Bylaws on obligations of listed companies, including examination of prospectuses.

One clerical support.

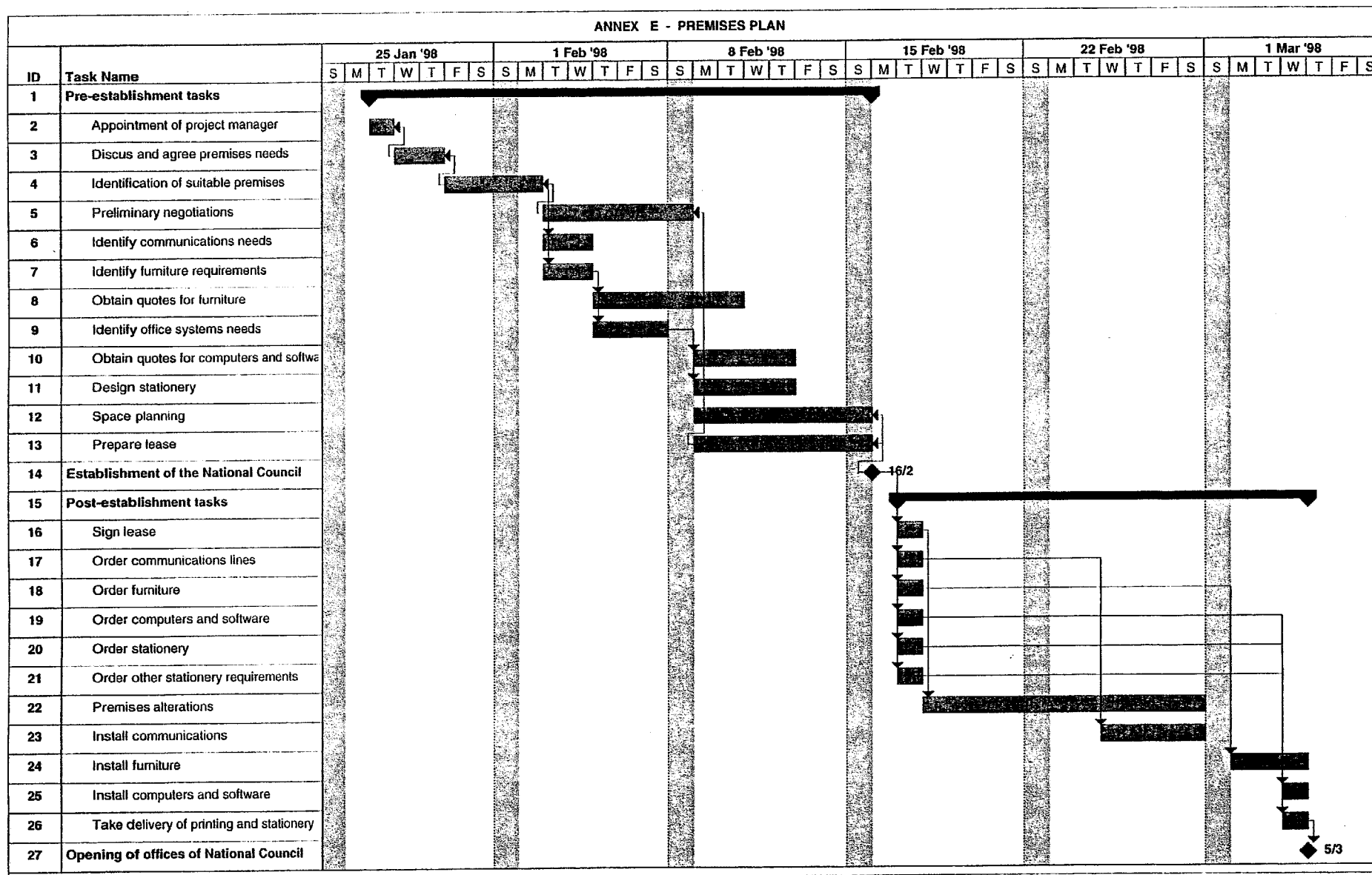
Annex C - Project Plan for Stages 1 and 2 (Stage 1)

ID	Task Name	'97			Sep '97					Oct '97					Nov '97					Dec '97					Jan '98					Feb '98					Mar '98																									
		17	24	31	7	14	21	28	5	12	19	26	2	9	16	23	30	7	14	21	28	4	11	18	25	1	8	15	22	1	8	15	22																											
1	NATIONAL COUNCIL PLANNING																																																											
2	National Council Development Plan																																																											
3	Submit to CB for Review																																																											
4	Discuss and agree																																																											
5	Central Bank signs off on plan																																																											
6	Approval by USAID to proceed																																																											
7	Plan for the passage of the Law																																																											
8	Establishment of the National Council																																																											
9	Draft bylaws																																																											
10	High & Medium Priority																																																											
11	Procedures Manual																																																											
12	Prepare Procedures Manual																																																											
13	Identify systems requirements																																																											
14	Prepare requirements specification																																																											
15	Staffing																																																											
16	National Council take on staff																																																											
17	Premises Plan																																																											
18	Continuing Support (Resident Adviser)																																																											
19	General Support (Legal Adviser)																																																											

Annex D - Preparation of High & Medium Priority Bylaws



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Annex F - Training and staff development plan

ID	Task Name	Apr '98		May '98		Jun '98		Jul '98		Aug '98		Sep '98		Oct '98			
		5/4	19/4	3/5	17/5	31/5	14/6	28/6	12/7	26/7	9/8	23/8	6/9	20/9	4/10	18/10	
1	Training																
2	Design Regulatory Training Course																
3	Deliver Regulatory Training Course																
4	Study Tour																
5	Overseas Courses																
6	Overseas Courses																
7	Design SI training programme																
8	Deliver SI training course																

5